

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

DOCUMENT CONTROL

AT RICHMOND, NOVEMBER 17, 2008

APPLICATION OF

2008 NOV 17 P 3:57

APPALACHIAN POWER COMPANY

CASE NO. PUE-2008-00046

For an increase in electric rates

FINAL ORDER

On May 30, 2008, pursuant to Va. Code § 56-582, Chapter 10, and the Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30 ("Rate Case Rules"), Appalachian Power Company ("Appalachian") filed with the Commission an application, with accompanying testimony and exhibits, for an increase in its base rates ("Application").

Appalachian asserted that the Application demonstrates the need for an increase in its base rates in the amount of \$207.9 million, a 23.9% increase in revenues. The base rate increase is derived from pro-forma revenues of \$1.14 billion, pro-forma expenses of \$1.05 billion, and a pro-forma rate base of \$2.4 billion. This proposed revenue requirement reflects a rate of return on rate base of 8.516%, based on a proposed rate of return on common equity ("ROE") of 11.75% and a projected capital structure for Appalachian as of June 30, 2008. Appalachian proposed to collect the \$207.9 million additional revenue requirement through changes to base rates effective June 29, 2008.

On June 6, 2008, the Commission issued an Order for Notice and Hearing and Suspending Rates directing Appalachian to provide notice of its Application; inviting comments on the Application by interested persons; scheduling a public hearing on the Application for October 29, 2008; and establishing a procedural schedule for the filing of testimony and exhibits by respondents and the Commission Staff. The Order also suspended the Company's proposed

rates for 150 days pursuant to § 56-238 of the Virginia Code, or through October 27, 2008, and thereafter permitted the Company to implement its proposed rates on an interim basis subject to refund with interest.

Notices of participation were filed by the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel"), Steel Dynamics-Roanoke Bar Division ("Steel Dynamics"), the VML/VACo APCo Steering Committee ("VML/VACo"), Wal-Mart Stores East, L.P. ("Wal-Mart"), The Kroger Company ("Kroger"), and the Old Dominion Committee for Fair Utility Rates ("Old Dominion Committee").

Pre-filed testimony was submitted on September 26, 2008, by Consumer Counsel, Steel Dynamics, Wal-Mart, Kroger and the Old Dominion Committee. Consumer Counsel recommended that the Commission reduce Appalachian's base rate increase. Steel Dynamics, Wal-Mart, Kroger and the Old Dominion Committee each asserted that Appalachian's proposed allocation of revenues across customer rate classes resulted in cross-subsidies and a return from certain classes that exceeds the cost of capital.

On October 10, 2008, the Staff filed testimony recommending that Appalachian's requested revenue requirement be reduced to \$156,775,333, calculated using Staff's cost of capital and an ROE of 10.1%. For example, Staff's proposed capital structure modifications, including reducing ROE to 10.1%, resulted in a decrease to revenue requirement. In addition, Staff proposed decreased revenue requirements for items such as operations and maintenance expenses, operating revenues, and charitable donations. Staff supported Appalachian's proposal to allocate the rate increase equally across all customer classes.

Appalachian filed rebuttal testimony on October 20, 2008, responding to the pre-filed testimony of Staff and other parties in support of its requested increase of \$207.9 million.

A public hearing was convened on October 29, 2008. The following were represented by counsel at the hearing: Appalachian; the Old Dominion Committee; Consumer Counsel; VML/VACo; Wal-Mart; Kroger; Steel Dynamics; and Staff. In addition, 15 public witnesses testified at the hearing in opposition to the proposed increase. Following the public witness testimony, the Company, certain parties, and Staff submitted a jointly executed stipulation ("Stipulation") recommending a resolution of the issues in this proceeding. The Stipulation provides that Appalachian, the Old Dominion Committee, VML/VACo, Wal-Mart, Kroger, and the Staff agree that the Commission should adopt a revenue requirement increase of \$167,867,699 for Appalachian, rather than the Company's requested revenue requirement increase of approximately \$207.9 million. According to the Stipulation, the increase is based on an authorized ROE range of 9.6% to 10.6%, and uses an ROE of 10.2% for purposes of setting the revenue requirement in this case.

The Stipulation further provides that consistent with the Staff's proposed treatment for Deferred State Income Taxes, as impacted by the Virginia coal tax credit carry-forwards, the Company shall implement the valuation allowance accounting set forth in the Stipulation. The Company also agreed to provide a minimum distribution system study in its next base rate proceeding.

The stipulating participants further agreed that the recommended revenue requirement increase of \$167,867,699 shall be allocated to the customer classes using the Company's proposed method of allocating the overall percentage increase to each class. The stipulating participants also agreed to the following rate design provisions: (1) the Large Power Service rates shall be designed to recover ninety percent (90%) of the demand related costs through the

demand charge; and (2) the Large General Service ("LGS") rates shall be designed to increase the current demand charge by no less than twenty percent (20%).

Next, consistent with Staff witness Stevens' proposal, the Company agreed to file a plan, prior to its next base rate filing, that would eventually move the intra-class LGS rates to full cost of service, on a demand and energy charge basis, with implementation of the plan to begin with its next base rate case.

The stipulating participants also agreed that the Company shall refund, with such interest and under such terms as the Commission may direct, the difference between the rates designed in conformance with this Stipulation and any rates placed in effect, subject to refund, by the Company in this proceeding.

Consumer Counsel did not sign the Stipulation, but stated that it did not oppose the agreement contained therein. Steel Dynamics opposed the Stipulation.

NOW THE COMMISSION, upon consideration of this matter, is of the opinion and finds that the jointly executed Stipulation should be accepted as a fair and reasonable resolution of this proceeding.

The rate increase we approve today represents a substantial reduction from the original increase requested by Appalachian in its Application. The Company requested slightly below \$208 million in additional revenues from its customers; today we reduce that revenue increase to slightly below \$168 million, a reduction of approximately \$40 million. In doing so, we do not consider any precedent to be established regarding specific adjustments or methodologies used by the Stipulation in developing the lower amount. Nevertheless, while we are cutting Appalachian's rate increase substantially from its request, we understand that the rate increase approved will still represent a hardship on many of Appalachian's residential and business

customers. We find, however, that this rate increase is consistent with the facts and laws that govern this case.

The record before the Commission reveals that a significant portion of the increase relates to capital expenditures made to generation and distribution facilities needed to provide service to customers. A large portion of this increase is attributable to environmental improvements made to the generation facilities to comply with federal laws and regulations. Additionally, Appalachian has made improvements to maintain the reliability of its distribution network in Virginia. These expenditures, plus associated operating costs and depreciation, have contributed to an upward pressure on rates. In its prior base rate case, the Company sought to recover in rates much of this investment by projecting capital expenditures; however, we denied recovery because funds had not actually been expended. As the Company has now actually spent these amounts, state law provides for their recovery in rates. We will continue to monitor Appalachian's expenditures in the future to ensure that Virginia ratepayers pay no more than is required under Virginia law.

In addition, as noted above, Steel Dynamics did not join in the Stipulation. Steel Dynamics opposed allocating the rate increase by the same percentage across all customer classes, as is proposed in the Stipulation. Specifically, Steel Dynamics asserted that too much of the rate increase has been allocated to large business customers. *See, e.g.*, Tr. 65-67. If we modified the Stipulation to reflect the rate allocation suggested by Steel Dynamics, the rates for some customers would be *higher* than those contained in the Stipulation. We reject Steel Dynamics' argument for purposes of this proceeding.

Accordingly, IT IS ORDERED THAT:

(1) Appalachian's Application for an increase in its base rates is granted in part, and denied in part, as set forth herein.

(2) The Stipulation presented by the parties and Staff is hereby accepted.

(3) Appalachian shall forthwith file revised tariffs and terms and conditions of service with the Commission's Division of Energy Regulation, in accordance with the findings made herein, for bills rendered on and after thirty (30) days from the date of this Final Order.

(4) Appalachian shall recalculate, using the rates and charges approved herein, each bill it rendered that used, in whole or in part, the rates and charges that took effect on an interim basis and subject to refund on and after October 27, 2008, and, where application of the new rates results in a reduced bill, refund the difference with interest as set out below within ninety (90) days of the issuance of this Final Order.

(5) Interest upon the ordered refunds shall be computed from the date payments of monthly bills were due to the date each refund is made at the average prime rate for each calendar quarter, compounded quarterly. The average prime rate for each calendar quarter shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin or in the Federal Reserve's Selected Interest Rates (Statistical Release H. 15) for the three months of the preceding calendar quarter.

(6) The refunds ordered herein may be credited to current customers' accounts (each refund category shall be shown separately on each customer's bill). Refunds to former customers shall be made by check mailed to the last known address of such customers when the refund amount is \$1 or more. Appalachian may offset the credit or refund to the extent of any undisputed outstanding balance for the current or former customer. No offset shall be permitted

against any disputed portion of an outstanding balance. Appalachian may retain refunds to former customers when such refund is less than \$1. Appalachian shall maintain a record of former customers for which the refund is less than \$1, and such refunds shall be promptly made upon request. All unclaimed refunds shall be subject to § 55-210.6:2 of the Code of Virginia.

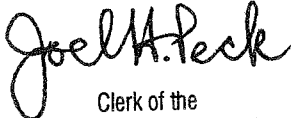
(7) On or before May 15, 2009, Appalachian shall deliver to the Divisions of Public Utility Accounting and Energy Regulation a report showing that all refunds have been made pursuant to this Final Order, detailing the costs of the refunds and the accounts charged.

(8) Appalachian shall bear all costs incurred in effecting the refund ordered herein.

(9) There being nothing further to come before the Commission, this matter is dismissed from the Commission's active docket and the papers filed herein placed in the Commission's file for ended causes.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:
Anthony J. Gambardella, Esquire, Woods Rogers P.L.C., 823 East Main Street, Suite 1200, Richmond, Virginia 23219; Shaun C. Mohler, Esquire, and Damon E. Xenopoulos, Esquire, Brickfield, Burchette, Ritts & Stone, P.C., 1025 Thomas Jefferson Street, N.W., Eighth Floor, West Tower, Washington, D.C. 20007-5201; Edward L. Petrini, Esquire, Christian & Barton, L.L.P., 909 East Main Street, Suite 1200, Richmond, Virginia 23219-3095; Kurt J. Boehm, Esquire, Boehm, Kurtz & Lowry, 36 East Seventh Street, Suite 1510, Cincinnati, Ohio 45202; Howard W. Dobbins, Esquire, Williams Mullen, P.O. Box 1320, Richmond, Virginia 23218; Holly R. Smith, Esquire, Russell W. Ray, P.L.L.C., 6212-A Old Franconia Road, Alexandria, Virginia 22310; C. Meade Browder, Jr., Senior Assistant Attorney General, Division of Consumer Counsel, Office of Attorney General, 900 East Main Street, 2nd Floor, Richmond,

Virginia 23219; and the Commission's Office of General Counsel and Divisions of Energy
Regulation, Public Utility Accounting, and Economics and Finance.

A True Copy
Teste: 
Clerk of the
State Corporation Commission